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Article abstract

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Relating to those provisions, the author will refer to considerations that will apply whatever the form of the joint venture.

Joint venture dissolution

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ABSTRACT

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RÉSUMÉ

Les contrats de coentreprise (joint venture) *et leur exécution recèlent beaucoup de difficultés, indécelables à prime abord, qui peuvent soit rendre l'entreprise non profitable, soit frustrer les cocontractants de leurs objectifs initiaux. Pour cette raison, les clauses les plus importantes dans un contrat de ce genre sont celles qui gouvernement sa cessation.*

Relativement à ces clauses, l'auteur nous fait part de conseils qui pourront s'appliquer quelle que soit la forme de l'entreprise.

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INTRODUCTION

1. Although joint ventures are becoming one of the most popular and effective means of conducting international business and of pooling international resources for huge projects, such as the Euro-Tunnel, they can be complex and difficult undertakings not only because different cultural, technical, political and commercial values and systems are involved, but also because they invariably encounter with time important changes in circumstances and conditions which are difficult to anticipate at the onset of the joint venture. These changes in circumstances and conditions may either frustrate the original goals of the joint venturers or render the undertaking unprofitable or unmanageable.

2. In order to maintain at an acceptable level the degree of risks that must be assumed, advance planning and efforts are required to anticipate problems that could frustrate the intentions of the parties. Thus, there are no more important provisions of the joint venture agreements than those which govern its termination, and yet these are among the provisions most frequently omitted or incomplete. Many joint venture partners, without strong urging by their professional advisers, are reluctant to consider the possibility and consequence of failure on the eve of a business marriage. Sometimes they are loath to raise the matter for fear of annoying the prospective partner or of creating an unfavourable negotiating climate. There is, however, as in marriage between individuals, no better time to consider and agree upon such matters.

3. Just as considerable care must be taken to assure that the goals of the joint venture can be achieved, advisers must also devote detailed advance planning and effort to ensure that, should the joint venture fail or terminate prematurely, one party does not suffer disproportionately.

4. The considerations which I will now refer to will apply whatever the form of the joint venture. Of course they should be modified to take into account whether the joint venture is a partnership, a corporation or a pure joint venture, and the specific laws governing the project. However, the same broad considerations should apply to all forms of joint venture and I shall not comment specifically on each form of agreement.

I. NORMAL TERMINATION

5. Short term joint ventures normally carry the simplest form of termination clauses and procedures, and the least problems. For instance, a joint venture formed for the purpose of constructing a particular project may well not last more than a couple of years and will

normally not involve complicated termination procedures. At the completion of the work, as certified by the project manager, the machinery and other assets of the joint venture will normally be sold or distributed to the partners as provided in the agreement and the inevitable process of negotiating any claims against the client will begin. This process will sometimes be long and protracted but will be greatly assisted if the right local partner has been chosen, *i.e.* one who has good contacts and enjoys a strong position within the country of the project. The contractual arrangements between the partners and between the joint venture client will only come to an end once the project has been completed, all claims are settled, and of course, all the warranty periods have expired.

6. Some joint ventures are entered into for a specific time period, in which case the termination is already determined at the outset, unless it has been postponed by joint consent of the parties. In such instances, the agreement will also provide for clauses stipulating how the assets of the joint venture are to be sold or distributed, how any claims between the clients and the joint venturers and between the joint venturers themselves shall be disposed of, and how the continuing relationships of the parties relative to warranties, confidentiality and sometimes non-competition covenants will be carried out.

II. CHANGES IN CIRCUMSTANCES OR HARDSHIP

7. Longer-term joint ventures, or joint ventures of indefinite duration, carry considerable risks which must be addressed if the Canadian partner is to avoid the impossible situation of being locked into an unprofitable venture or with an undesirable partner for a long period of time in a foreign country where the environment may well be difficult.

8. It will be a delicate balance to achieve in the agreement to provide for the necessary exits which the partners will want to safeguard for themselves without making it too easy for the prospective partner to bail out prematurely or too easily from an undertaking which normally requires a lot of effort and considerable investment in financial, technological and human resources.

9. It is wise to provide in long-term or indefinite joint ventures the conditions which give one or all partners the right to bail out of a joint venture by forcing either its dissolution or the purchase or sale of his or their interest in the joint venture. Although most countries do have laws of a general nature governing dissolution or winding up of corporations or partnerships, in cases of stalemate, it is best for the partners themselves to determine at the outset which specific events or circumstances should trigger such rights.

Specific clauses to be negotiated in order to provide for a right of withdrawal will obviously depend on the circumstances of each joint

venture, such as the nature of the project, the country where the joint venture will be located, and the nature of the participants which very frequently are government-owned or controlled and do not necessarily have the same business motivations as the Canadian partner. The following list of subjects to be negotiated as conditions triggering the right to withdraw is not exhaustive but will serve as an indication giving you the flavour for the type of questions which you may encounter.

(i) a governmental or similar action which could reduce a party's share in the joint venture to less than 50 % or some other agreed basic percentage;

(ii) a governmental action which impairs a party's ability to receive the benefits of the joint venture agreement or prevents one or more of the parties from performing their obligations or exercising their rights thereunder;

(iii) as of a certain date after the start of the joint venture, the inability for a party to receive, in Canadian dollars or other currency, dividends or returns from the joint venture in each fiscal year and in an amount sufficient to constitute a certain agreed minimum return on investment;

(iv) any new income taxes, withholding taxes or similar taxes imposed by a government upon the joint venture's dividends to the Canadian party, which would not be creditable for Canadian income taxes, unless the Canadian party will be compensated or indemnified to the extent necessary to place it in the same economic and financial position it would have been, had such taxes been creditable or had they not been introduced;

(v) the effective exclusion of Canadian party from participation in the management or control of the joint venture due to causes beyond its control, including but not limited to the imposition of, or compliance with, any law, act, decree or regulation in the country where the joint venture is in effect;

(vi) the denial of requisite visas, work permits, or residence permits for employees of the Canadian party or its directors or representatives, including attorneys, accountants and advisors, to enter, reside and work in and exit the country where the joint venture is in effect;

(vii) the expropriation or nationalization of any property of the joint venture or of any direct or indirect ownership interest therein;

(viii) a breach by the other party of any of the provisions of the joint venture agreement in any respect and the continuance of such breach for a certain period after the Canadian party has given notice in writing to the other party demanding cure thereof;

(ix) the bankruptcy, insolvency, reorganization or an admission by a party of its inability to pay its debts generally as they become due;

(x) a change in the control or the beneficial ownership of 50 % or more of the voting securities or interests in the other party or in any person directly or indirectly controlling the other party without the consent of the Canadian party;

(xi) in the case of technology or industrial joint ventures, the failure of the joint venture company or of the other party to respect the quality control standards or norms or the maintenance and after-sale services standards of the party providing the technological or industrial expertise;

(xii) a "hardship" or "change in circumstances" clause, *i.e.* a clause acknowledging that the Canadian party's decision to enter into the joint venture was motivated by the favourable attitude of the local government towards foreign investment as evidenced by its policies, foreign capital investment laws and its constructive administration of those laws and policies; the clause could provide that if, in the reasonable judgment of the Canadian party, this favourable foreign investment climate has ceased to exist, or if the applicable laws have been repealed, amended or modified, or if that country's administrative policy has been materially and negatively modified, then the Canadian party shall have the right at its sole option to declare that a triggering event has occurred.

Clauses of the latter type are obviously extremely difficult to negotiate but would constitute a first-class protection when dealing with unstable countries.

III. CONSEQUENCES OF WITHDRAWAL

10. The withdrawal of a partner from a joint venture or its dissolution will normally entail serious consequences for the other partners, especially since the special contribution of each partner is usually a major reason for its very existence. The withdrawing partner may well be the one who brings to the joint venture its technological expertise, or who gives access to its principal market or who is its principal supplier or client.

A withdrawal will modify the nature of the control exercised on the joint venture.

This change of control in itself could bring about serious consequences for the continued existence of the joint venture, especially if questions of nationality of the joint venture, or of domestic or foreign content are important. For instance, the withdrawal of a foreign partner could mean the reassessment of the fiscal environment or, on the contrary, the withdrawal of a national partner could mean a breach of conditions under which the joint venture was formed and allowed to operate in a foreign country.

Foreign partners who wish to withdraw from a joint venture will also inevitably face problems of exchange controls or problems of liquidity with respect to the repatriation of their investment and assets.

11. Since withdrawal could signify the end of the joint venture, the joint venture agreement should provide for the fair indemnification of the foreign partners and for the orderly liquidation of the different assets and contractual agreements involved. Normally the right to sell or assign an interest in a joint venture is severely restricted by making it subject to the prior approval of the other party, except if such assignment is in favour of affiliated or associated companies in order to give some freedom of operation within groups. Another method frequently used and less restrictive consist of giving some right of first refusal in favour of the other parties, should a partner wish to sell or transfer its shares in the joint venture.

IV. SALE OF INTEREST AND DISSOLUTION

12. There are basically three methods of either withdrawing or causing the dissolution of a joint venture and these are not basically different from any other form of shareholders' agreement or partnership agreement. Normally, when a party has acquired the right to withdraw or to require the dissolution, the agreement provides for such party to have the right to elect one of the following procedures :

(a) the right to purchase all shares or interest of the other party in the joint venture;

(b) the right to compel the other party to purchase all of the withdrawing party's shares or interest in the joint venture; or

(c) the right to require the dissolution of the joint venture.

In the first two instances, the agreement should provide for a transfer price which would be based on some form of valuation of the total market value of the joint venture's business, and stipulate the method of payment. Dissolution clauses will normally specify the laws under which the dissolution of the joint venture will occur, and the procedures to be followed for the dissolution of the joint venture and the distribution of its assets and liabilities.

V. ONGOING RESPONSIBILITIES

13. In addition to the method of withdrawal and dissolution, the agreement should provide for the method of coping with the ongoing responsabilities and contractual agreements which will continue despite the end of the joint venture. For instance, in manufacturing joint ventures, some provision must be made in order to comply with the

obligations to the joint venture's customers such as product warranties and after-sale services. Continuing obligations regarding confidentiality of information exchanged or acquired during the joint venture will normally form the subject of an additional agreement. Furthermore, in some instances, non-competition agreements for specific periods and territories will be ongoing obligations of the parties despite the dissolution of the joint venture or the withdrawal of one or more of the parties. There may be other ancillary agreements which need to be contemplated, to cover such matters as technological assistance, marketing and employment of joint venture personnel.

VI. TECHNOLOGY JOINT VENTURES

14. In a technology joint venture, the agreement must provide for the "unravelling" of the rights and obligations of the former partners and for the transfer and licensing of the technology and patents contributed to and developed by the joint venture. In such ventures, a transfer of technology is often part of the essence of the deal, whether in the joint venture agreement itself or by way of ancillary assignment or license agreements. The primary patents and technology that relate to the development and business activities to be conducted by the joint venture will normally be transferred either by an outright assignment or by a license, which is often exclusive. In the event of termination, it is easier to recapture rights assigned to the joint venture by way of license. A license also permits licensing of others under the same patents for other fields of use where appropriate. A joint venture may also acquire on a non-exclusive basis, from one of its partners, background patent and technology which are useful to the joint venture but which such partner continues to use for its other business purposes.

The joint venture agreement must therefore carefully address the reversion of the rights in patents and technology which were granted to the joint venture and the disposition of the rights of the partners in the new patents and technology developed jointly through joint venture activities. Needless to say, negotiation of these aspects often proves to be more difficult and time consuming than the negotiation of almost all other provisions of the agreement combined.

Among other things, the agreement should specify the extent to which :

i) rights to the original patents and technology are to be reassigned or licensed back to the original owner;

ii) rights, if any, to such original patents and technology are to be cross-licensed between the partners or licensed or sub-licensed to the joint venture entity if it continues its existence;

iii) rights to jointly-developed patents and technology are to be licensed or sub-licensed to each of the partners by the joint venture entity.

CONCLUSION

While the contribution and interests of the parties are fairly well defined at the beginning of a joint venture, the situation becomes more complex as the venture progresses. The parties must consider that the venture may fail or be terminated for unforeseen circumstances in order to provide adequately for the orderly disposition of rights and assets when relations may not be as cordial, or circumstances may not be as favorable, as at the time of initial negotiations.